

24 Feb 1987

MEMORANDUM FOR: Chief, Information and Management
Support Staff/OL

STAT FROM:

Chief, Procurement Management Staff, OL

SUBJECT: Grace Commission Report - Personnel Management
Operations - PER 12

Dave:

1. The following comments are offered on the subject:

PER 12-1.1: The legislation should establish a firm national policy on acquiring goods and services from the private sector.

Comment: Other sections of the Grace Commission Report have recommended flexibility. I believe that a firm national policy should be supported but note that CIA has exempted itself from OMB Circular A-76 (with proper notice to OMB). The exemption for CIA should be continued on the basis that our intelligence mission makes many tasks sensitive and suitable only for performance by government employees that could be contracted out in other agencies. One example would be our world-wide communications systems.

PER 12-1.2: The legislation should also provide that OMB has authority to approve limited exceptions to the general policy based on predetermined criteria which will allow for necessary flexibility.

Comment: As stated in our comments on PER 12-1.1, the CIA should be exempt from any mandatory requirement to contract out. The DCI must have the authority to make decisions impacting performance of the intelligence mission. As a general observation, it would seem that if predetermined criteria for exemption can be established, then OMB Circular A-76 could be properly drafted to allow the President's heads of executive agencies to carry out this policy.

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PER 12-1.3: Legislation should revise the cost comparison handbook procedures to make the analysis less complicated and detailed.

Comment: CIA should support this recommendation. A major complaint for a long time has been that you need a task force of experts or an outside contractor to do the cost comparison.

2. The Grace Commission properly notes that a major problem with gaining maximum benefit from OMB Circular A-76 has been the vacillation from one president to the next as to how much emphasis should be placed in relying on the private sector. This seems to follow party lines, with Republican presidents wanting to rely on the private sector and Democratic presidents going the other way.



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II. ISSUE AND RECOMMENDATION SUMMARIES (CONT'D)

C. PERSONNEL MANAGEMENT OPERATIONS (CONT'D)

PER 12: PERMANENT EMPLOYMENT VERSUS CONTRACTED SERVICES

Issue and Savings

Can more Federal functions be contracted out to private sector firms at a lesser cost?

There is potential to reduce the overall Federal budget by about \$1 billion annually or, adjusted for inflation, approximately \$3.3 billion in the first three years following implementation. This can occur through the implementation of an effective program of contracting out Government activities that are basically commercial in nature.

Background

The Office of Management and Budget (OMB) is responsible for establishing, monitoring, and revising policies, regulations, and procedures for Federal procurement. The Executive Branch's first directive on procurement was issued in 1955.

On April 5, 1979, OMB made a major revision with renewed emphasis on reliance on the private sector for goods and services. This was done to remedy certain implementation problems and to protect affected Government employees. Major provisions are:

- o In-house activities would not be converted to a contracted service unless it resulted in a savings of at least 10 percent in personnel-related costs.
- o A clause was placed in the contract that requires the contractor to hire all displaced employees who desire employment.
- o An agency must show that its operation is functioning as efficiently as possible in-house before entering cost comparative studies.
- o Both the contractor and the in-house cost estimates must be based on the level of performance required to get the work done.

- o Cost comparison analysis must be completed following the established format.
- o An audit of cost comparison analysis will be made by an independent auditor [General Accounting Office (GAO)].
- o The agency is prohibited from using this program to circumvent personnel ceilings.
- o Critical functions of the Government must be performed by Government personnel (involving or exercising authority, controlling monetary transactions, and entitlements).
- o If for some reason the contracted service is found to be ineffective, the agency will revert to in-house service.

The present administration is placing strong emphasis on reducing the size of Government through increased dependence on contracting services from the private sector. For example, the Deputy Director of OMB directed the Executive Branch Agencies to accelerate implementation and use of Circular A-76 -- the primary tool for achieving this goal. This same circular waives the requirement for cost comparisons on critical defense issues. ✓

Methodology

Because of the significant dollar savings potential to be gained from increased contracted services, the Task Force focused on personal interviews and inquiries to reach conclusions on this issue.

Managers at GAO, the Office of Personnel Management (OPM), Internal Revenue Service, Department of Navy, Department of Army, and OMB were interviewed to get a better understanding of the present use of required cost comparison studies and the potential dollar savings if certain functions of the Federal Government were contracted out to private sector firms.

Findings

GAO has determined 1/ that there are thousands of activities within Government Agencies that could be contracted out without affecting the services rendered. These activities represent over \$6 billion in annual operating costs and

1/ The GAO Report (FPCD-81-43) June 19, 1981.

\$3 billion in capital outlays that have never been subjected to cost comparisons to determine if contracting out was economically feasible. An OMB estimate ^{2/} shows that if cost comparisons were performed, 60 percent of the activities would be converted to contracted services. This would save the Government an estimated \$5 billion over the next six years.

The GAO outlines its concern in its report to Congress entitled Civil Servants and Contract Employees -- Who Should Do What For The Federal Government, dated June 19, 1981. In some instances Federal Agencies have used contractors and consultants to perform work that should be done by Federal employees because it involved basic management decisions. GAO lists several examples to support this concern in a June 1981 report. These include the determination of agency authority to perform functions; planning, developing, establishing goals and priorities; and substantially determining agency policies.

A 1978 GAO report discussed the overall effectiveness of agency policies and programs for acquiring commercial or industrial products and services. Some of the findings of that report were:

- o The A-76 policy was not perceived as a national policy with full Executive and Legislative Branch approval and support.
- o Over the years, policy pronouncements and applications were controversial and unsettled.
- o The implementation by Executive Departments and Agencies was inconsistent and relatively ineffective.
- o Make or buy decisions were not necessarily based on sound management principles that would result in an economical and effective Government.

GAO and OMB have collected data and documentation on the cost-effectiveness of contracted services versus in-house services. For example, janitorial services contracted out by the General Services Administration (GSA) average a 50 percent savings over in-house service. OMB estimated that 70 percent of GSA's commercial functions, which employ 30,000 individuals, could be contracted out to the private sector with a cost savings of 50 percent. However, GSA has been moving very slowly in converting these functions. In 1972, it had 7,800 janitorial employees; in 1979, it was

^{2/} The OMB letter of June 30, 1982 from David A. Stockman to the President of the U.S. Chamber of Commerce.

down to 5,500, even in light of the tremendous cost savings that could be gained on conversion to contracted services. At this rate, it will take 15 years to convert all such services resulting in unrealized savings of over \$250 million. Based on past experience, the average savings for contracted services in the Federal Government are 20 percent of the total cost.

Like past administrations, this administration is concerned with the need to focus on reducing the size of Government by increased dependence on the private sector. Circumstances where the Government may operate a commercial or industrial activity, as specified by OMB's Office of Federal Procurement are:

- o Lack of satisfactory private source,
- o Military necessity, and
- o Relative cost.

Some agencies, however, are reluctant to contract out for services because it is viewed as threatening for the following reasons:

- o Lack of complete control by the agency,
- o Small business failures resulting in breaks in continuity of products and services,
- o In some instances, the agency not provided with needed quality to meet requirement for awarding contract to lowest bidder, and
- o Union problems.

Federal managers who were interviewed stated that the OMB procedures for making cost comparison studies were too complex and time consuming. The Task Force reviewed the procedures and concurred with this statement. For more details and information concerning these procedures and the need for improvement, reference is made to the PPSS Procurement Task Force Report.

Conclusions

There is a need for a legislative mandate that would require agencies to contract out services to the private sector whenever the results of an adequate cost comparison study demonstrate that doing so is economically sound. Cost

comparison analysis is a fair and equitable process. The A-76 directive has the necessary built-in protection for the present, in-house functions and the affected employees.

There is strong Administration support for the converting of products and services to private sector firms if cost effectiveness can be demonstrated. If agency cost comparisons show that a reasonable percentage of commercial or industrial work presently being performed in-house can be done more economically by contract, agencies should be able, as a condition of the contract award, to transfer affected employees to the contractor.

Without legislation, the Executive Branch is likely to continue shifting policy emphasis that affects agency willingness to perform required cost comparisons and to contract for products and services. With legislation, agencies will be more likely to implement the A-76 policy since the action dictated by the results of the cost comparison study will have the effect of law.

Recommendations

PER 12-1: OMB should prepare legislation that mandates an agency to conduct and implement the results of cost comparison analyses on all functional areas as outlined by OMB Circular A-76, "Policies for Acquiring Commercial or Industrial Products and Services for Government Use." OMB should also revise and reissue Circular No. A-120, "Guidelines for the Use of Consulting Services" to require additional management controls to ensure that Governmental functions are not performed by contractors.

PER 12-1.1: The legislation should establish a firm national policy on acquiring goods and services from the private sector.

PER 12-1.2: The legislation should also provide that OMB has authority to approve limited exceptions to the general policy based on predetermined criteria which will allow for necessary flexibility.

PER 12-1.3: Legislation should revise the cost comparison handbook procedures to make the analysis less complicated and detailed.

Savings and Impact Analysis

OMB has received from the agencies a breakdown of estimated savings to be realized in FY 1982 and FY 1983 if a conversion to contracted services were initiated following A-76 cost comparison studies. These totals reflect a potential savings of about \$1 billion in 1982 with the elimination of 132,664 Federal positions. OMB projected cumulative savings to total \$5 billion over a six-year period (1982 through 1987).

Implementation

Once the proper legislation is enacted, the instrument is in place for implementation. OMB Circular A-76 would need only the strength of legislation to call for mandatory use of cost comparison analysis for specific functions and the implementation of the results. OMB would distribute information to all Federal Agencies on the new regulations and procedures.

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Approved For Release 2005/08/02 : CIA-RDP87-01146R000100010040-8

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Approved For Release 2005/08/02 : CIA-RDP87-01146R000100010040-8